No. 7002.

IN THE

United States Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

Thomas A. O'Donnell,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.

PETITION FOR REHEARING.

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TABLE OF CASES AND AUTHORITIES CITED.

PAGE

Earl S. Gwin v. Commissioner of Internal Revenue, 14 B. T. A. 393 11

Harrison et al. v. Nixon, 34 U. S. 480, 9 L. Ed. 201 10

Phillips, et al. v. Commissioner, decided 1931, 51 Sup. Ct. 608, 283 U. S. 589 6

Mabel G. Reinecke v. Smith, decided April 10, 1933 .... 3, 4

David B. Roberts v. Commissioner of Internal Revenue, 19 B. T. A. 351 10

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To the Honorable Curtis D. Wilbur, William H. Sawtelle and Julian W. Mack, Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Comes now Thomas A. O'Donnell and presents this his petition for a rehearing of the above entitled case and in support thereof respectfully shows:

1. The opinion of this Honorable Court is contrary to the opinion of the United States Supreme Court in the case of *Mabel G. Reinecke v. Smith,* decided April 10, 1933, unreported to date.

2. The opinion of this Honorable Court is contrary to law in that it fails to recognize the rules of the United

States Board of Tax Appeals which place the burden of proof upon the Respondent.

3. The opinion of this Honorable Court is contrary to law in that it approves a finding made by the Board on an issue not presented to the Board, and on which Petitioner had no opportunity of presenting evidence, thus working a grave injustice upon Petitioner.

Since the opinion of this Honorable Court was rendered, the Supreme Court of the United States rendered its opinion in the case of *Mabel G. Reinecke v. Smith*, decided April 10, 1933, which involved the constitutionality of section 219 of the Revenue Act of 1924 insofar as it applied to income received during the year 1924 by revocable trusts created prior to the year 1924. In this case the Government contended that the Revenue Act of 1924 was not retroactive. The Supreme Court, among other things, stated:

> "Petitioner maintains the section in terms applies in the circumstances disclosed; as the tax is laid *only upon income accruing after January 1, 1924, the statute is not retroactive;* and, as the grantor retained a measure of control, to tax him upon the income is not arbitrary or unreasonable though the trusts were created before any statute had laid a tax upon the settlor measured by the income of such a trust.
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> * * * * * * * *
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> "Nor do we think the act has such a retroactive effect as to render its requirements arbitrary within the principle announced as to estate and gift taxes in *Nichols v. Coolidge*, 274 U. S. 531; *Untermyer v. Anderson*, 276 U. S. 440, and *Blodgett v. Holden*, 275 U. S. 142. In those cases the issue was the

> validity of a tax on a transaction consummated before the enactment of the statute authorizing the exaction. *In the present case the subject of the tax is not the creation of the trusts or the transfer of the corpus from the grantor to the trustees, but the income of the trusts which accrued after January 1, 1924, the effective date of the Revenue Act of 1924.* Although the Act was passed June 2, 1924, the imposition of the tax on income received or accrued from the beginning of the year has been held unobjectionable. *Cooper v. United States,* 280 U. S. 409, 411." (Italics ours.)

The Supreme Court laid great emphasis on the fact that section 219 of the Revenue Act of 1924 was not being applied to income accrued prior to January 1, 1924. The inference is inescapable that the Act would have been held unconstitutional had it applied to income received prior to the year 1924.

This language of the Supreme Court, together with the rulings of the Commissioner under acts prior to 1924, holding the trustee liable for the tax and not the trustor of revocable trusts, it is respectfully submitted, conclusively demonstrates that section 219 of the Revenue Act of 1924 was an expression of a new purpose rather than a clarification of prior laws. Taxpayers who comply with the Commissioner's rulings, it is respectfully submitted, should be given the benefit of all doubts in the construction of the Act.

In view of the foregoing, it is respectfully urged that the opinion of this Honorable Court should be modified to conform to the opinion of the United States Supreme Court in the above cited case.

The rules of the Board of Tax Appeals specifically place the burden of proof on the respondent in those cases wherein he affirmatively alleges facts tending to increase the deficiency from which the appeal was originally taken. The Supreme Court of the United States has in effect approved the rulings of the United States Board of Tax Appeals and in at least one case has recognized that the burden of proof is upon the Commissioner. See the case of *Phillips, et al. v. Commissioner*, decided 1931, 51 Sup. Ct. 608, 283 U. S. 589.

The pleadings before the Board of Tax Appeals raised only one question of fact (in addition to the question of law herein presented) and that was the fair market value of the rights acquired by Petitioner under his contract with the Petroleum Midway Company, Ltd. This is evident from the following quotation taken from the Respondent's answer.

> "Respondent alleges that the fair market value, if any, of the rights acquired by the petitioner by virtue of the contract entered into between the Petroleum Midway Company, Ltd. and the petitioner herein, on January 9, 1918, and referred to above in paragraph I-a, did not exceed the sum of $75,000.00 on the last named date." [R. p. 15.]

It is evident from the foregoing that the Respondent's theory of the additional tax was based upon the fair market value of the contractual rights received by Petitioner on January 9, 1918, which the Board held could not be determined. There is nothing in the pleadings, therefore, which raised any question whatsoever as to the fair market value of the stock of the San Gabriel Petroleum Company in June, 1917.

Relying upon the pleadings and rules of the Board of Tax Appeals, placing the burden in the instant case upon Respondent, counsel for Petitioner offered no evidence. Counsel's opinion that the question of fact raised in the pleadings had not been established by the evidence submitted by the Respondent is confirmed by the findings of fact and opinion of the United States Board of Tax Appeals.

Quite naturally Petitioner offered no evidence with respect to the fair market value of the stock in the San Gabriel Petroleum Company acquired by Petitioner in June, 1917. Had this been an issue before the Board, the Respondent and the Petitioner would have offered evidence to prove the value. It is believed that a very substantial value could be proven.

In its opinion this Honorable Court stated:

> "Now it is evident that the parties to this transaction all considered that one-third of the stock of the San Gabriel Company was worth $75,000 over and above the obligations of the company during the period from December 31, 1917, to January 9, 1918, when the deal was consummated."

The Board of Tax Appeals having found and concluded that no value could be established, it is respectfully urged that the opinion of this Honorable Court should have been for Petitioner. The $75,000 paid McCray brothers plus the obligations of the company (which were not even shown in the record), it is respectfully urged, do not prove value. In order to establish the value, it was certainly incumbent upon the Respondent to prove just what the obligations were. The price that was paid by the purchaser

on January 9, 1918, would naturally be more determinative of the fair market value of the properties transferred by Petitioner, than the option moneys and the unproven obligations. What the McCrays thought their options were worth could not establish fair market value. The fact remains that Petitioner considered the property worth in excess of this because he kept his interests as well as acquiring the interests of the McCrays. What the purchaser considered the value of the properties acquired is the real criterion of value. This, the Board held, was not established by the evidence despite the fact that it was the only question of fact raised in the pleadings.

It is more reasonable to assume on account of the record that the obligations—money and drilling—may have been in excess of $413,672.14 than to assume they were less. What the McCrays were willing to accept for their options given by them in December, 1917, cannot, it is respectfully urged, be considered as establishing the fair market value of all the properties transferred by Petitioner on January 9, 1918. The record is silent as to whether or not oil was discovered on the properties between December 31, 1917, and January 9, 1918. The absence of this, under the Board's rules, should redound to the benefit of the Petitioner. It was not incumbent upon Petitioner to prove when oil was discovered. Under a proper construction of the Board's rules and the question raised in the pleadings the burden was upon the Respondent to prove by competent evidence the fair market value of the rights acquired by Petitioner on January 9, 1918. As heretofore indicated, the obligations undertaken by the purchaser may have amounted to a million dollars. Certainly the price the

purchaser paid on January 9, 1918, for the properties is the best criterion of fair market value.

The decision of this Honorable Court works a grievous injustice upon Petitioner. He relied, as he had reason to rely, upon the pleadings before the Board and upon its rules placing the burden of proof upon the Respondent. Having thus relied upon the rules, he should not now be penalized for not having offered evidence on an issue not then raised. This court, in its opinion, stated:

> "The finding of the Board of Tax Appeals that the value of this property exchanged for the royalty agreement was not in excess of $413,672.14 amounts in effect to a finding that petitioner had theretofore recovered his capital investment in said royalty agreement and the stipulation of facts supports that finding. This is the fact with which the Board of Tax Appeals was particularly concerned and not the exact value of the property exchanged for the royalty agreement."

The foregoing statement may be the ultimate question to be determined in a proper determination of Petitioner's tax liability for the year involved. However, the Respondent, charged with establishing the fact, relied, as shown by his pleadings, solely upon the theory that the contractual rights acquired by Petitioner on January 9, 1918, did not have a fair market value in excess of $75,000.00. The Board having concluded that this fact had not been established, it should, under its own rules of procedure and the established law, have held that Respondent had failed to make his case. The rules of the Board and the pleadings of the parties in cases pending before that Board

should be given the same effect that is given to the rules of the court and the pleadings before the court.

The Supreme Court in the case of *Harrison et al. v. Nixon,* 34 U. S. 480, 9 L. Ed. 201, stated:

> "Every bill must contain in itself sufficient matters of fact, *per se,* to maintain the case of the plaintiff; so that the same may be put in issue by the answer, and established by the proofs. The proofs must be according to the allegations of the parties; and if the proofs go to matters not within the allegations, the court cannot judicially act upon them as a ground for its decision; for the pleadings do not put them in contestation. The *allegata* and the *probata* must reciprocally meet and conform to each other."

To the same effect see also the decision in the case of *David B. Roberts v. Commissioner of Internal Revenue,* 19 B. T. A. 351, in which the Board stated, at pages 354 and 355:

> "The issues raised by the pleadings constitute the only issues we are called on to decide. * * *
>
> "We find much reluctance in the necessity as we see it of deciding a cause on the inadvertence of counsel or a slip in pleading. Clearly, a cause should go off on such a point only when required by some rule of law, the observance of which is deemed essential to the proper functioning of the Board.
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> "The Board, by statute, is given power to make rules of procedure. Pursuant to such authority, the Board has prescribed by rule that:
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> A proceeding shall be initiated by filing * * * a petition * * *. It shall contain:
>
> (d) Clear and concise assignments of error alleged to have been committed by the Commissioner.

> "The rule is fundamental that a plaintiff must recover, if at all, on the case made by his declaration, and if he fails to prove his cause of action as laid, or proves an entirely different one, he can not recover."

The Board of Tax Appeals in the case of *Earl S. Gwin v. Commissioner of Internal Revenue,* 14 B. T. A. 393, held that an affirmative allegation on the part of the Commissioner that an amount received by the petitioner constitutes taxable income is not established by a showing that the amount alleged was received and that it would not have been received, but for certain services rendered by the petitioner.

Where courts raise new issues parties litigant should have an opportunity to defend. Petitioner, in the instant case, through no fault of his own has been denied that right. If the determination of the fair market value of the stock of the San Gabriel Petroleum Company acquired by Petitioner on June 28, 1917, is properly to be considered an issue, then it is most respectfully submitted that Petitioner should be given the opportunity of introducing evidence to disprove the inferences that might have been raised from the stipulation. Neither party at the time of the trial considered that the value of the San Gabriel Petroleum Company stock on June 28, 1917, had anything to do with the issues involved in the case. The finding of the Board [R. p. 31] that the fair market value of the stock of the San Gabriel Petroleum Company on June 28, 1917, was not in excess of $413,672.14 was a surprise to Petitioner and is believed was a surprise to Respondent. If, to determine the tax liability of Petitioner for the year

herein involved, it is necessary, as the Board considered it, to determine the fair market value of that stock, then justice would require either that judgment be given for the Petitioner, because of the failure of the Respondent to prove the facts alleged in his answer, or that the case be remanded for further proceedings.

Wherefore, upon the foregoing grounds it is respectfully urged that this petition for a rehearing be granted and that the order of the Board of Tax Appeals be upon further consideration reversed.

Respectfully submitted,

THOMAS R. DEMPSEY,

A. CALDER MACKAY,

Attorneys for Petitioner.

Certificate of Counsel.

I, counsel for the above named Petitioner, do hereby certify that the foregoing petition for a rehearing is presented in good faith and in judgment of counsel for Petitioner, is well founded and that it is not interposed for delay.

....

Of Counsel for Petitioner.